family in a loss of means of support action, you do not have the same sympathetic factors in your favor as you do when representing the innocent person who is injured or his family.

A final suggestion: Avoid getting involved in multiple divisions or counts for injuries to person, property, means of support, etc., if you have a marginal or average case. You will not only get involved in headaches of pleading and proof, but you will stay awake nights preparing your instructions.

FINAL PAYMENT AND WARRANTIES ON PRESENTMENT UNDER THE UNIFORM COMMERCIAL CODE— SOME ASPECTS

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I. INTRODUCTION

Most checks are processed and paid in the normal course of events by the payor bank[1] without fanfare. Frequently, though, there are competing claims for payment and it becomes important to determine whether there has been final payment.[2] The necessity of making that determination implies that not all payments are final. Whether a payment is indeed final, or whether it may be recovered despite its apparent finality may be determined by sections 3-417, 3-418 and 4-213 of the *Code*. Final payment must be considered in light of the two latter sections. Section 4-213 prescribes those events which constitute final payment by a payor bank, while section 3-418 sets out those conditions under which a payment may be recovered even though final under section 4-213. Thus, the concept of finality does not preclude recovery by the payor bank unless there has been final payment within the context of both sections 3-418 and 4-213. Such finality is really a product of balancing the equities between the parties, particularly in those cases where each party seems equally innocent.

II. ASPECTS OF FINAL PAYMENT

Under section 3-418,[3] payment may be final in favor of a holder in due course or a person who has in good faith changed his position in reliance on

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1. UNIFORM COMMERCIAL CODE, 1962 Official Text, Section 4-105(b). "'Payor bank' means a bank by which an item is payable as drawn or accepted;" (Further references to the CODE will be to the 1962 Official Text unless otherwise indicated).

2. U.C.C. § 4-213:

(1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:

(a) paid the item in cash; or

(b) settled for the item without reserving a right to revoke the settlement, and without having such right under statute, clearing house rule or agreement; or

(c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or

(d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b), (c) or (d) the payor bank shall be accountable for the amount of the item.

3. U.C.C. § 3-418: "Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment."

the payment. There are two basic exceptions to the finality rule. The first has to do with the recovery of an improper payment if the bank returns an item or sends written notice of dishonor before final payment and its midnight deadline. The other exception permits recovery of a payment if there is a breach of warranty on presentment.[4] The two exceptions to finality of payment covered in section 3-418 apply even in the case of a holder in due course. The payor bank may recover payment from the holder if it acts within the time limits prescribed in section 4-301 or if there is a breach of warranty on presentment.

It may be useful to review section 4-213 briefly in an attempt to focus on the time of final payment. The time of final payment may be determinative in fixing the relative priorities between parties competing for the same funds. It may also be important in determining priority[5] between an item[6] and a stop-payment order. Payment of an item in cash[7] is the simplest way of making final payment under section 4-213.[8] The other methods have caused some problems because of the questions necessarily involved in determining whether the process of posting has been completed, or whether the payor bank has failed to revoke a settlement in time.[9] The latter event arises normally because of the deferred posting provision[10] which requires a settlement[11] on the date that an item is received, but keeps that settlement provisional with the right to revoke until the midnight deadline.[12] The failure of the bank to revoke a provisional settlement in time makes that settlement final and makes the bank accountable for the amount of the item.[13] The payor bank may also retain a right to revoke through clearing house rules or by general agreement with its depositors. Besides final settlement and cash payment, the payor bank

4. U.C.C. § 3-418 refers to "warranty on presentment under the preceding section . . ." meaning section 3-417(1). It is to be presumed that section 4-207(1), dealing with checks in the bank collection process, is also included.

5. U.C.C. § 4-303. This section sets out the tests for determining the priority between an item and stop-order. It includes other tests in addition to those set out for final payment in section 4-213.

6. U.C.C. § 4-104(g): " 'Item' means any instrument for the payment of money even though it is not negotiable but does not include money. . . ."

7. In *Kirby v. First & Merchants Nat'l Bank*, 210 Va. 88, 168 S.E.2d 273 (1969), the court held that payment was made in cash and, therefore, there was final payment of a $2,500 check where the payor bank had given the payee $200 in cash and accepted a $2,300 deposit in the currency column of the deposit ticket to the credit of the payee's account in the same bank. The bank was trying to recover the money because the check was drawn on insufficient funds. The CODE does not expressly provide for the split payment situation.

8. Fidelity & Casualty Co. v. Planenscheck, 200 Wis. 304, 227 N.W. 387 (1929). *See also* Bellevue Bank of Allen Kimberly & Co. v. Security Nat'l Bank, 168 Iowa 707, 150 N.W. 1076 (1915).

9. U.C.C. § 4-301.

10. *Id.*

11. U.C.C. § 4-104(1)(j): " 'Settle' means to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final. . . ."

12. U.C.C. § 4-104(1)(h): " 'Midnight deadline' with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later. . . ."

13. *See* text of section 4-213, *supra* note 2.

may accomplish final payment of an item by completing the process of posting the item[14] to the account of the drawer. The process of posting is defined in section 4-109 as the usual procedure followed by a payor bank in making and recording payment, including one or more steps as determined by the bank.[15] One of the steps that a payor bank may take under that section is "correcting or reversing an entry or erroneous action with respect to the item."[16] In *West Side Bank v. Marine National Exchange Bank*,[17] the right of the payor bank to reverse an entry was upheld since the clearing house deadline had not expired when the reversal was made. This case gave priority to a stop payment order even though the payor had previously completed all steps evidencing its payment of the check. According to the court, the process of posting was not yet completed because the clearing house deadline had not expired. A literal reading of section 4-109(e) indicates that reversing an entry comes within the process of posting even if the original entry is not itself erroneous. In other words, the adjective "erroneous" seems to qualify only the word "action" but does not qualify "entry." This interpretation broadens the concept of the process of posting by giving the payor bank until its midnight deadline to decide whether it will indeed correct or reverse an entry even though there may be no error and even if all other steps in section 4-109(a)-(d) are taken. A logical consequence of this interpretation is to make redundant the language of section 4-301 dealing with final payment, since there can be no final payment before the midnight deadline and the payor bank will be protected as long as it returns the item or sends written notice of dishonor before that deadline.

If the payor bank is not also the depositary bank, it must settle for the item by midnight of the banking day of receipt and, in any event, regardless of whether it is also the depositary bank, it must pay or return the item by the midnight deadline.[18] Failure by the payor bank to act within the applicable time limits of section 4-302 makes it accountable for the amount of the

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14. U.C.C. § 4-109: The "process of posting" means the usual procedure followed by a payor bank in determining to pay an item and in recording the payment including one or more of the following or other steps as determined by the bank:
(a) verification of any signature;
(b) ascertaining that sufficient funds are available;
(c) affixing a "paid" or other stamp;
(d) entering a charge or entry to a customer's account;
(e) correcting or reversing an entry or erroneous action with respect to the item.

15. *See* Brown v. South Shore Nat'l Bank, 1 Ill. App. 3d 136, 273 N.E.2d 671 (Ill. Ct. App. 1971), where the court held that signature verification and, if necessary, correction or reversal of erroneous action, were part of the process of posting. It held that the payor's action in returning the check to the payee's bank marked "Not Paid" and "Paid in Error" indicated that the posting process was not completed even though the bank originally treated the check as paid.

16. *See* U.C.C. § 4-109(e), *supra* note 13.

17. 37 Wis. 2d 661, 155 N.W.2d 587 (1968). It was held that the payor bank had until its midnight deadline to reverse any entry but the court also recognized that this was subject to the good faith provisions of the CODE. *See also* Note, *Final Payment and the Process of Posting Under the Uniform Commercial Code*, 68 COLUM. L. REV. 349 (1968), Gibbs v. Gerberich, 1 Ohio App. 2d 93, 203 N.E.2d 851 (1964), Yandell v. White City Amusement Park, Inc., 232 F. Supp. 582 (D. Mass. 1964).

18. U.C.C. § 4-302.

item. Where the payor bank has complied with the settlement requirements and wishes to revoke that settlement, it may do so as long as final payment has not been made.[19] That right of revocation ought not to be available, in the absence of a valid defense, if the process of posting has been completed. In other words, the process ought not to be extended to the midnight deadline if all other steps required by the bank have been taken. It would seem, then, that in the absence of a breach of warranty, finality of payment under section 3-418 should prevail in favor of a holder in due course or a person changing his position in good faith, if the process of posting has been completed, and that recovery of the payment should be allowed only if the entry has indeed been erroneous or otherwise improper. A different interpretation creates finality of payment only after the midnight deadline of the payor bank has expired.[20] The suggested approach fully recognizes the two steps inherent in the process of posting.[21] The payor bank must make the determination to pay the item and then must record the payment in some appropriate manner. If the obligation of good faith pervades the *Code*,[22] then it would seem that a payor bank should not be able to reverse an entry at the mere whim of its customer. The balancing of equities ought to place the burden on the payor which decides to pay and then translates that decision into the appropriate book entry.

III. Unauthorized Signatures

Even if final payment has been made under section 4-213, recovery of that payment is still available under section 3-418 if there is a breach of warranty on presentment.[23] For example, in the case of a forged endorsement,

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19. *In re* Schenck's Estate, 63 N.Y. Misc. 2d 721, 313 N.Y.S.2d 277 (1970). In this case the bank accepted checks drawn on itself in payment of notes owed by the decedent. The checks were not posted until the day following the customer's death. It was held that there was final payment since the decedent's funds were immediately appropriated to reduce his indebtedness.

20. *See* Note, *Final Payment and the Process of Posting under the Uniform Commercial Code*, 68 Colum. L. Rev. 349 (1968) where the *West Side* case is criticized as "justified neither by statutory language nor by a weighing of the relevant policies."

21. *See* Leary, *Check Handling Under Article Four of the Uniform Commercial Code*, 49 Marq. L. Rev. 331 (1965).

22. U.C.C. § 1-203: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."

23. U.C.C. § 3-417(1) provides:

> (1) Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that
>
> (a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title; and
>
> (b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by a holder in due course acting in good faith
>
> (i) to a maker with respect to the maker's own signature; or
>
> (ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or
>
> (iii) to an acceptor of a draft if the holder in due course took the draft after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized; and
>
> (c) the instrument has not been materially altered, except that this warranty is not given by a holder in due course acting in good faith
>
> (i) to the maker of a note; or

the holder who obtains payment from the payor bank breaches his warranty of good title[24] and payment is not final under section 3-418. In the case of the forged signature of a drawer, there is no breach of warranty unless the person obtaining payment has knowledge of the forgery. The drawee who pays out on the forged signature of the drawer cannot recover from the person paid. This doctrine evolved from the celebrated case of *Price v. Neal*,[25] where the drawee was denied recovery from the endorsee after paying out on an instrument which had a forged signature. This case attempted to balance the equities of equally innocent parties. Its rationale has been subject to various interpretations. It is said that the drawee is presumed to know the signature of its customer[26] and is in the best position to detect the forgery.[27] The difficulty here is that the drawee must still bear the loss if the signature is so expertly forged that the forgery cannot be detected within the normal course of events.[28] In the case of a forged endorsement, the person obtaining payment breaches his warranty of title. It is said that the payor bank is not in a position to verify an endorsement in the chain of title and therefore it should be protected by a warranty from the person presenting the instrument.[29] The rationale for treating forged signatures and forged endorsements differently is less than compelling. The reasoning fails because in the case of an expert duplication of the signature of the drawer, a reasonable review by the payor bank at the time of payment will reveal nothing amiss.[30] Yet in this case, the payor cannot charge the account of its customer. A more palatable rationale is the public policy consideration of providing finality in commercial transactions.[31]

There is a breach of warranty with respect to the forged signature of a drawer if the person obtaining payment or acceptance has knowledge of the forgery. Knowledge is defined in the *Code* as "actual knowledge."[32] The clear

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(ii) to the drawer of a draft whether or not the drawer is also the drawee; or

(iii) to the acceptor of a draft with respect to an alteration made prior to the acceptance if the holder in due course took the draft after the acceptance, even though the acceptance provided "payable as originally drawn" or equivalent terms; or

(iv) to the acceptor of a draft with respect to an alteration made after the acceptance.

24. U.C.C. § 3-417(1)(a).

25. Price v. Neal, 3 Burr. 1354, 96 Eng. Rep. 871 (1762).

26. *See* F. Woodward, The Law of Quasi Contracts § 82 (1913) [hereinafter cited as Woodward], where the author explores the rationale behind *Price v. Neal.*

27. U.C.C. § 3-418, Comment 1.

28. *See* Ames, *The Doctrine of Price v. Neal*, 4 Harv. L. Rev. 297, 298 (1891). [hereinafter cited as Ames] where the author suggests that the basis for the decision is not the drawee's negligence.

29. U.C.C. § 3-417, Comment 3.

30. *See* Commerce-Guardian Bank v. Toledo Trust Co., 60 Ohio App. 337, 21 N.E.2d 173 (1938).

31. Woodward, *supra* note 26, § 87.

32. U.C.C. § 1-201(25): A person has "notice" of a fact when

(a) he has actual knowledge of it; or

(b) he has received a notice or notification of it; or

intent of this provision is to place the burden on the payor bank unless it can be shown that the person paid had knowledge of the forgery at time of payment. Mere suspicion is not enough to place liability on the person warranting lack of knowledge under section 3-417(1)(b). The competing equities of the holder and the payor bank are balanced in favor of the former unless he has actual knowledge of the forged signature. If the conduct of the person paid is such as to be equated with bad faith, then payment is indeed not final under section 3-418.[33] But payment may be final if the person obtaining payment exhibits honesty in fact, even if the circumstances invite enquiry into the validity of the signature of the drawer.[34]

The warranty of section 3-417(b) is not applicable in certain cases to a holder in due course acting in good faith. The warranty is not given to a maker with respect to his own signature nor to a drawer with respect to his own signature. In addition, it is not given to an acceptor of a draft if the holder in due course takes the draft after acceptance or obtains acceptance without knowledge that the signature of the drawer is unauthorized.[35] These exceptions are predicated on the rationale that the maker, drawer, and acceptor should know their own signatures and therefore should be called upon to suffer the loss when pitted against the holder in due course.[36] A respectable query is whether the knowing holder in due course may present a forged note hoping that the maker will not recognize the forgery. At first blush, it seems as if the equities suggest recovery to the holder in accordance with the *Price v. Neal* doctrine. The difficulty revolves around the good faith requirement.[37] If the holder in due course acquires knowledge of a forgery after he has taken the instrument, he will be hard pressed to benefit from the exception if he is required to act in good faith on presentment. Knowledge in that case will negate good faith and the warranty will be breached by the holder in due course who obtains payment. Therefore, the good faith requirement must mean something other than actual knowledge. The *Code* defines it as honesty in fact in the conduct or transaction concerned.[38] It is possible that the *Code* draftsmen intended to protect the holder in due course who acquires

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(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. . . .

33. U.C.C. § 3-418, Comment 3 states: "If he [the holder] has taken the instrument in bad faith or with notice he has no equities as against the drawee."

34. U.C.C. § 1-201(19): " 'Good faith' means honesty in fact in the conduct or transaction concerned."

35. *See* note 23 *supra.*

36. U.C.C. § 3-417, Comment 4 explains it this way: "Since a maker of a note is presumed to know his own signature, if he fails to detect a forgery of his own signature and pays the note, under the *Price v. Neal* principle he should not be permitted to recover such payment from a holder in due course acting in good faith."

37. Note, *Finality of Payment and the Uniform Commercial Code,* 32 TEMP. L.Q. 182, 192 (1959) asks the following question: "How can a holder in due course be exempted from making the warranty of no knowledge of a maker's forged signature and nevertheless act in good faith if he presents a note while possessed of that information?"

38. *See* note 34 *supra,* for the definition.

knowledge of a forgery but that intention has not been clearly manifested. While the *Code* comment[39] attempts to supply an explanation for the good faith language,[40] it does not provide a practical example as to how the exception operates. One possible reading of the language is that the holder in due course cannot cling to his protective shield amidst all the suspicious circumstances which point to a forgery of the signature of the drawer. The reasonable interpretation may be that knowledge of forgery is incompatible with good faith and in order for the good faith language to operate, there has to be a different approach to the definition for purposes of section 3-417(1)(b). It has been suggested by one commentator that the subjective test should be abandoned in favor of the objective test[41] by virtue of the *Code* provision providing for an alternative definition where the context so requires.[42] The difficulty with substituting the objective test for the subjective test is that it overlooks the express intention of the *Code* draftsmen[43] to disavow the approach of *Gill v. Cubitt*[44] in defining good faith. The objective definition would remove the aspect of incompatibility which exists between the *Code* definitions of good faith and knowledge. As previously suggested, there is also room for a different definition where the context requires.[45] But this variation may reasonably be interpreted as increasing the burden of the holder in due course, who must fulfill the subjective good faith requirement to achieve his status as a holder in due course, but who would then have to meet a different standard between the time of taking and presentment of the instrument. This calls for a distinction in the meaning of good faith within the same subsection of the *Code*.

Another possible approach is to regard the good faith requirement as not necessarily excluding knowledge, but rather as creating an affirmative obligation on the presenter to inform the payor of the forgery of a signature in order that the payor may promptly protect his rights against the forger. Knowledge in this case would not be incompatible with good faith, but would be an essential element of the exercise of that good faith. The other solution may be to regard the holder in due course as acting in good faith if he does nothing to mislead the payor at the time of presentment. In other words, mere inaction by the presenter would qualify as good faith conduct once the presenter has done nothing to induce a false sense of security on the part of

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39. U.C.C. § 3-417, Comment 4.

40. *See* Note, *The Doctrine of Price v. Neal Under Articles Three and Four of the Uniform Commercial Code*, 23 U. PITT. L. REV. 198, 209-10 (1961) where the author agrees that "the Code itself seems to have difficulty in explaining the result that its rule apparently demands."

41. Finan, *Check Payment: Finality Under the Uniform Commercial Code*, 1 AKRON L. REV. 26, 34 (1968).

42. U.C.C. § 1-201 provides definitions for use throughout the CODE but the introduction says that they apply "unless the context otherwise requires. . . ."

43. 1956 Recommendations of the Editorial Board for the Uniform Commercial Code.

44. 3 B. & C. 466, 107 Eng. Rep. 806 (1824).

45. *See* note 42 *supra*.

the payor.[46] In this case, the problem of accommodating knowledge and good faith[47] simultaneously will still be present. But this is apparently the intention of section 3-417(1)(b) and it is within this framework that some solution must be found. Since the *Code* comment[48] suggests that knowledge of the forgery acquired after the taking but before the presentment does not operate as a disability to the exercise of good faith by the holder in due course, it seems eminently reasonable that the holder must take some affirmative action to place the payor in the best position to defend himself. The fulfillment of this requirement may be manifested in different ways depending on the facts of the particular case. The *Code* comment suggests that the good faith act is not negated merely by the existence of knowledge. The substance of the matter is in determining the conduct of the holder in due course once he gains knowledge. The holder may have the duty to act promptly as soon as he learns of the infirmity attending the instrument and his failure to do so may indeed militate against his claim of an exercise of good faith. If he informs the payor of the facts or if he supplies information in response to an enquiry, he may be deemed to be acting in good faith. This is an acceptable method of accommodating the element of knowledge with the act of good faith.

IV. Notice, Knowledge and Good Faith

In this context, an examination of the notice definition in the *Code* is suggested.[49] The holder has notice of a fact under that definition when he has reason to know that it exists because of the facts and circumstances known to him.[50] This definition seems to meet the objective test. Despite this, there may be an overlapping between good faith and notice. One may have notice and still be acting in good faith, but it is not the same to say that one may have knowledge of a forgery without doing more and still be acting in good faith under section 3-417(1)(b).[51] The *Code* comment, therefore, heightens the mystery by an assertion that the holder in due course must continue to act

46. One commentator has suggested that the good faith language in section 3-417 (1)(b) will "probably be construed as applying to any overt conduct or words accompanying a presentment with knowledge which have the affect of lulling the payor and stifling his usual precautions in the examination of signatures, etc., especially in the case of signature by an agent." Leary, *Warranties to a Payor Under the Code*, 48 Kentucky L.J. 225 n.63 (1960).

47. *See* Braucher, *UCC Article 3—Commercial Paper—New York Variations*, 17 Rutgers L. Rev. 57, 72 (1962), where the author says that the New York Clearing House objected to the good faith language "on the ground that the rights of a holder in due course should not be affected by knowledge acquired after he takes the instrument." The assumption was that good faith in this context was incompatible with knowledge of the forgery of the instrument.

48. U.C.C. Section 3-417, Comment 4.

49. *See* note 32 *supra* for the definition of notice.

50. *See* Security State Bank v. Baty, 439 F.2d 910 (10th Cir. 1971), where the court held that the purchaser of a check did not have notice preventing him from being a holder in due course just because he knew that the drawer did not have sufficient funds in his account to cover the check. A bank official had assured him that the drawer would have the funds on deposit when the check was presented for payment.

51. *See* Note, *Notice and Good Faith Under Article 3 of the Uniform Commercial Code*, 51 Va. L. Rev. 1342 (1965) for a good discussion of notice.

in good faith after acquiring knowledge of a forgery in order to be exempt from the basic warranty.[52]

The precise distinction between notice and knowledge has not always been clear either. In *Fair Finance Co. v. Fourco, Inc.*[53] the defendant had erroneously overcomputed interest on an instrument which it had endorsed to the plaintiff without recourse. The plaintiff sued the defendant under section 3-417(3) on the theory that the latter did have knowledge of a defense and the appellate court agreed with that contention. The conclusion of the court highlights the deep difficulty in distinguishing sometimes between notice and knowledge. The erroneous computation of the interest in this case did not give the defendant actual knowledge of a defense. The word "knowledge" receives a narrow definition in the *Code* and that definition does not encompass the presumption of knowledge from the mere existence of facts. It is as if the knowledge has to be an active assimilation of particular facts. It does not flow necessarily from the existence of circumstances which would provide a clue to the unusually perceptive individual. The difficulty does not end there. It is further complicated by the evolution of the good faith definition. In *Gill v. Cubitt*,[54] the court established the objective standard of good faith by maintaining that the plaintiff, holder of a bill of exchange, had to pass the prudent man test as applied to the events surrounding the transfer of the instrument to him. This rule was embraced by the courts in the United States and became a part of negotiable instruments law. But the rule was short-lived, for a few years later in *Goodman v. Harvey*,[55] the court abandoned that rule and insulated the purchaser from attack unless it could be shown that he had taken the instrument in bad faith or by fraud. American courts were thereafter split in their allegiance to the two rules enunciated in the two cases but the United States Supreme Court later followed *Goodman v. Harvey* in another case[56] and most state courts picked up the thread thereafter. The 1952 version of the *Code*[57] required the holder to take the instrument "in good faith including observance of the reasonable commercial standards of any business in which the holder may be engaged" if he hoped to enjoy the status of a holder in due course. Later *Code* editions have required the holder to take the instrument "in good faith." The deletion evidenced an intention not to incorporate the objective test laid down in *Gill v. Cubitt*.[58] The delicate care exercised by the draftsmen in dealing with the good faith language is some indication that its importance cannot be overlooked in any context.[59] While honesty in fact may satisfy

52. U.C.C. § 3-417, Comment 4. *See also* Mellinkoff, *The Language of the Uniform Commercial Code*, 77 YALE L.J. 185, 220 (1967), where the author draws attention to this drafting mystery. He agrees that the language "holder in due course acting in good faith" amounts to doubletalk when used in the warranty section.
53. 14 Ohio App. 2d 145, 237 N.E.2d 406 (1968).
54. *See* note 44 *supra*.
55. 4 A. & E. 870, 111 Eng. Rep. 1011 (1836).
56. Goodman v. Simonds, 61 U.S. (20 How.) 343 (1857).
57. U.C.C. 1952 Official Text, Section 3-302(1)(b).
58. *See* note 44 *supra*.
59. *See* note 43 *supra*.

the *Code* definition of good faith, a holder may find himself confronted with circumstances which may bring him within the pale of notice. Thus while the objective test may indeed be excluded from the good faith concept, it may be important in determining whether the notice requirement has been satisfied.

The good faith exception is continued in the case of a materially altered instrument. Section 3-417(1)(c) provides for an absolute warranty by the person obtaining payment or any prior transferor that the instrument has not been materially altered. There are four basic exceptions to the rule which operate in favor of a holder in due course acting in good faith. These exceptions apply on the theory that the maker, drawer and acceptor should know whether there has been an alteration when the instrument is presented for payment or acceptance. It is to be noted that whereas knowledge is an important element in the warranty dealing with unauthorized signatures, it does not come into play with respect to the warranty against material alteration Yet, both warranty sections require the holder in due course to act in good faith if he is to benefit from the exceptions contained therein. Since lack of knowledge of a material alteration is ordinarily no excuse under 3-417(1)(c) with respect to the person obtaining payment or acceptance, the holder in due course acting in good faith must be presumed at presentment to have no knowledge of any alteration to be exempt from the strict liability of that warranty. In that case, then, good faith does seem to have some meaning. It allows the holder in due course to avoid the absoluteness of the warranty in four cases if he has no knowledge of the material alteration, which lack of knowledge would ordinarily not be pertinent in assessing liability. If the language "acting in good faith" were omitted from section 3-417(1)(c), the exceptions included therein would apply to all holders in due course. The good faith requirement would be important only at the point that the holder took the instrument so as to qualify him as a holder in due course. Presentment of the draft thereafter to the acceptor would create no warranty liability with respect to an alteration made before acceptance. The element of knowledge with respect to the alteration would be immaterial as long as that knowledge was acquired after the holder in due course took the draft. The consequence of including the "good faith" language is to impose some additional element on the holder in due course status. That status is created at the time the holder takes the instrument and one of its essential elements is that the holder takes the instrument in good faith. A further embellishment is unnecessary if the good faith requirement of section 3-417 does not refer to events subsequent to the acquisition of the status of a holder in due course. The exception stated in section 3-417(1)(c) is not granted to the "holder in due course" but rather to the "holder in due course acting in good faith" and the import of the additional language must be to create a standard of conduct which applies up to the time of presentment of the draft by the holder in due course.

While it is true that the acceptor engages pursuant to section 3-413 that he will pay the instrument according to its tenor at the time of his engagement,

his engagement does not explain the good faith requirements of section 3-417. The warranties run with each transfer of the instrument so that every transferor in the line of title makes the warranties to the payor. Thus a strict construction of the contract of the acceptor under section 3-413 does not provide much solace to the holder in due course unless he acts in good faith. The warranty of section 3-417 applies to him as well as to others. The contract of the acceptor under section 3-413 is effective to fix the acceptor's liability if there is indeed no breach of warranty under section 3-417. The same principle is applicable in the case of payment. While a bank may indeed make final payment under section 4-213, the finality of that payment may be upset if the warranty of presentment is breached.

Under section 3-418, payment is also final with respect to a person who in good faith changes his position in reliance on payment. There again the good faith language reappears. Its use here does not cause the problems encountered by its use in section 3-417(1)(b) and (c). The element of good faith is present in the definition of holder in due course and it is in the normal sense that the term is used in section 3-418. The distinction is made that a person need not satisfy the other requirements of the status of a holder in due course in order to enjoy the protection of that section, as long as he has in good faith changed his position in reliance on payment. The distinction is important insofar as the section grants protection to the holder in due course with respect to either payment or acceptance, but grants it to the good faith holder only with respect to payment and only if he has changed his position in reliance thereon.[60] It is clear that the change of position must be made in good faith. Even before the *Code,* the holder could not forestall recovery by the payor if the holder took the payment in bad faith or by fraud.[61] There is no evidence that this position has been displaced by the *Code.*[62] Section 1-103 provides for the application of the principles of law and equity unless displaced by the particular provisions of the *Code* and this leaves room, therefore, for the use of the particular pre-Code rules of restitution.[63] The inclusion of the requirement of good faith with respect to a change in position in reliance on payment under section 3-418 is perhaps symptomatic of the concern for the equities of the parties. If the holder has obtained payment in bad faith or with notice, then he has no equities as against the drawer.

V. Holder in Due Course and Material Alteration

Another example of statutory difficulty is the exception operating in favor of the holder in due course in section 3-417(1)(c)(iii),[64] which follows the

60. First Nat'l City Bank v. Altman, 3 UCC Rep. Serv. 815 (N.Y. Sup. Ct. 1966), *aff'd mem.* 277 N.Y.S.2d 813 (A.D. 1967) discussed the reliance element.
61. *See* Ames, *supra* note 28, at 297.
62. U.C.C. § 3-418, Comment 3.
63. Restatement of Restitution § 34 (1937).
64. *See* text in note 23 *supra.*

decision in *Wells Fargo Bank & Union Trust Company v. Bank of Italy.*[65] In this case, the name of the payee was changed by a thief who inserted his own name, had the check certified and then endorsed it to the defendant bank. The defendant then procured payment from the plaintiff without notice of the alteration. It was held that the plaintiff could not recover payment from the defendant. Section 3-417(1)(c)(iii) purportedly codifies this decision[66] and under that provision a holder in due course in a *Wells Fargo* situation does not give the warranty against material alteration to the acceptor with respect to an alteration made prior to acceptance, if the holder in due course took the draft after acceptance. The question is whether the defendant in *Wells Fargo* qualifies as a holder in due course. It cannot be a holder in course without being a holder[67] and there is serious question whether a presenter in the position of the defendant in that case qualifies as a holder under the circumstances.[68]

The problem revolves initially around the status of the thief who steals order paper. He does not fall within the definition of a holder[69] because the instrument is payable to the order of another, and therefore, it cannot be regarded as being issued or endorsed to him or to his order. A transfer by the thief to another party cannot confer holder status either because the thief's endorsement is not that of the holder of the instrument.[70] It is a forged endorsement and a subsequent transfer to another party will not absolve that party from liability under section 3-417(1)(a) when that instrument is presented for payment. In the *Wells Fargo* case, the payee's name was changed and then the check was endorsed by the thief. This endorsement was not that of the original payee, the person for whom the check was destined. The thief was to all intents and purposes in the same category as one who simply forged the name of the original payee. The initial accomplishment of altering the payee's name should not lead to a conclusion that good title is therefore effected through an endorsement in the altered name.[71] In this connection, a further complication arises under section 3-417(1)(a). The party taking through a forged endorsement breaches the warranty of good title when he presents the instrument for payment. The *Wells Fargo* situation does not seem to present any compelling case for deviating from the rule that the transferee under a forged endorsement

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65. 214 Cal. 156, 4 P.2d 781 (1931). *See also* National City Bank v. National Bank of Republic, 300 Ill. 103, 132 N.E. 832 (1921).

66. *See* U.C.C. § 3-417, Comment 5.

67. U.C.C. § 1-201(20): "'Holder' means a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank."

68. *See* O'Malley, *Common Check Frauds and The Uniform Commercial Code*, 23 RUTGERS L. REV. 189, 264 (1969), where the author discusses the meaning of "holder" in the alteration situation and concludes that it cannot be given the strict CODE definition.

69. *See* definition in note 67 *supra*.

70. U.C.C. § 3-202(2) provides: "An indorsement must be written by or on behalf of the holder and on the instrument or on a paper so firmly affixed thereto as to become a part thereof."

71. *See* Palmer, *Negotiable Instruments Under The Uniform Commercial Code*, 48 MICH. L. REV. 255, 298 (1950), where the difficulty of reconciling *Wells Fargo* and section 3-417 is discussed.

runs afoul of the good title warranty when he presents the instrument for payment.

The codification of the *Wells Fargo* result in section 3-417 causes some problems. A different definition of the term "holder" is required if the *Wells Fargo* decision is to be perpetuated under that section. It is somewhat akin to the flexibility called for in the definition of the "good faith" language in section 3-417(1)(b). Where the payee's name has been altered, an endorsement by the alterer cannot confer "holder" status on the transferee and, therefore, the warranty exceptions of section 3-417(1)(c)(iii) cannot apply. Since the endorsement of the original payee is necessary to confer holder status on the transferee, the result in the *Wells Fargo* situation can be reached under the *Code* if the term "holder in due course" is defined as "bona fide purchaser for value."[72] The result cannot be otherwise sustained. This suggested definition can be extended in certain cases to a "holder in due course" under section 3-418. For example, if a bona fide purchaser takes a check more than thirty days after its issue, he is not a holder in due course simply because of the overdue instrument. But if section 3-418 indeed follows the *Price v. Neal* doctrine, payment ought to be final in his favor. This is so because the equities do not support recovery of the payment if there is no breach of warranty, no fraud and no bad faith on the part of the holder. But a literal reading of section 3-418 does not grant protection in this case unless the bona fide holder has changed his position in reliance on the payment.

VI. Conclusion

The concept of final payment can be understood only by appreciating the task which the *Code* draftsmen faced in trying to balance the equities between the parties in difficult situations. In this respect, some accommodation must be made for the imprecision which may be present in the discussed sections. If a reasonable understanding of the equities prevails, then that accommodation is facilitated. It is clear, though, that some revision is needed if the *Code* language wishes to consider more closely the equities of the parties. Otherwise, the relationship between sections 3-417, 3-418 and *Price v. Neal* will be muddled.

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72. *See* White, *Some Petty Complaints About Article Three*, 65 Mich. L. Rev. 1329 (1967), where the author suggests that a court might interpret the word "holder" to mean "bona fide purchaser for value."